

Designing a System for Structured Assessment of Compliance Risk



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Outline

1. A New Perspective
2. Analyzing the SC² tax shelter using Structured Argumentation
3. Evolving the SC² Argument
4. Benefits to IRS

Glossary

- **Structured Argument** – Formal reasoning approach using a hierarchical set of questions.
- **SEAS** - Structured Evidential Argumentation System (SRI software to generate structured arguments)
- **CRiSP** - Compliance Risk Pattern (associated with complex multiple return filings)
- **SC²** - S-Corporation tax shelter

SC² Characteristics

- Multi year scheme involving multiple tax entities (S-Corp, Non-Profit, and individuals) to reduce effective tax rate for business owners.
- Unlikely to be spotted on single tax return.
- Automated scoring systems do not detect.
- Spans multiple IRS divisions: S-Corp (LMSB), individual owners (SBSE), non-profit entity (TEGE).

A New Perspective on Assessing Compliance Risk for Complex Entities

CURRENT PRACTICE

single tax return for a specific year

line items on tax return

automated scoring

separate IRS divisions



TRANSITION

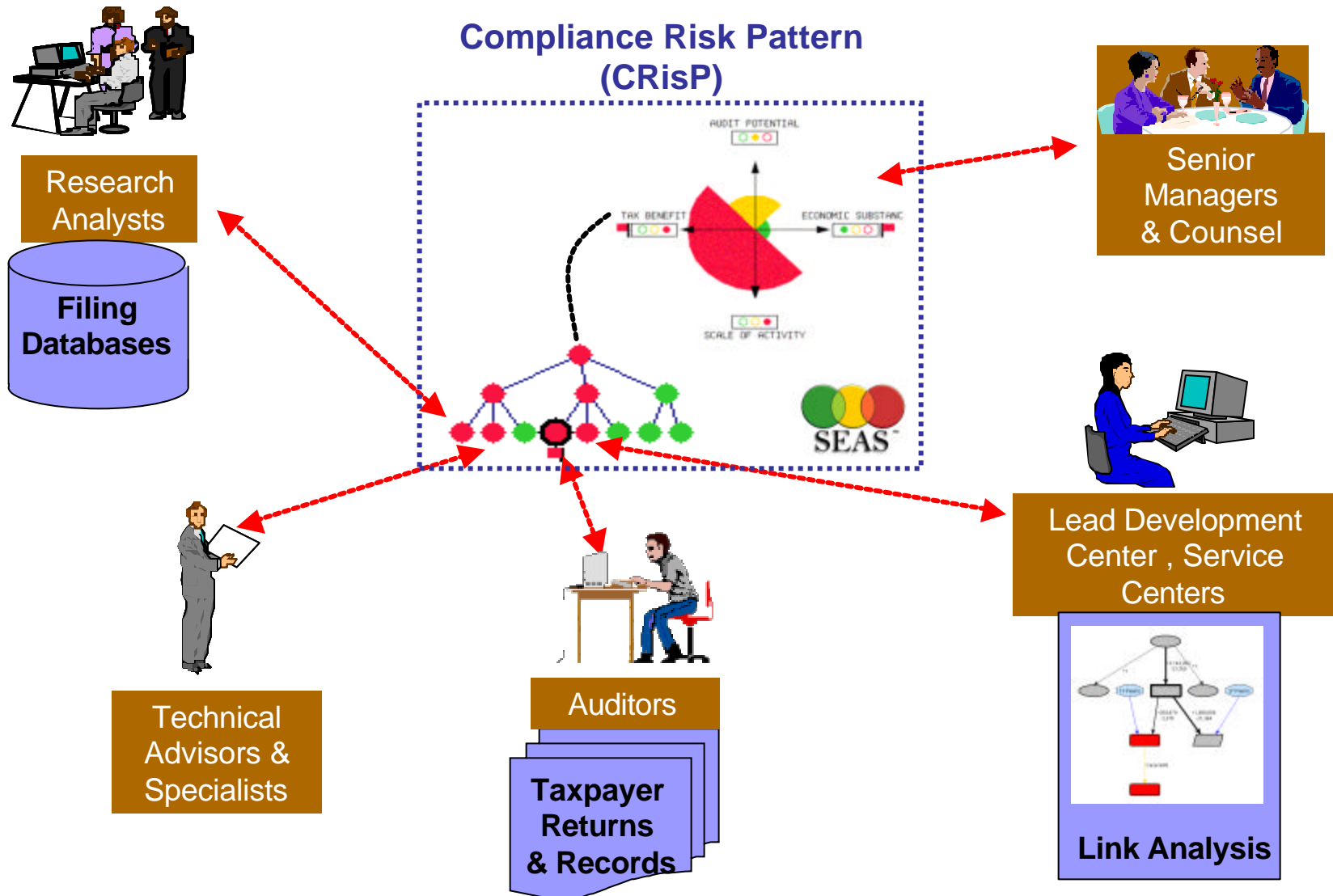
group of related entities over multiple-years (filing footprint)

methods to counter the use of “good optics”

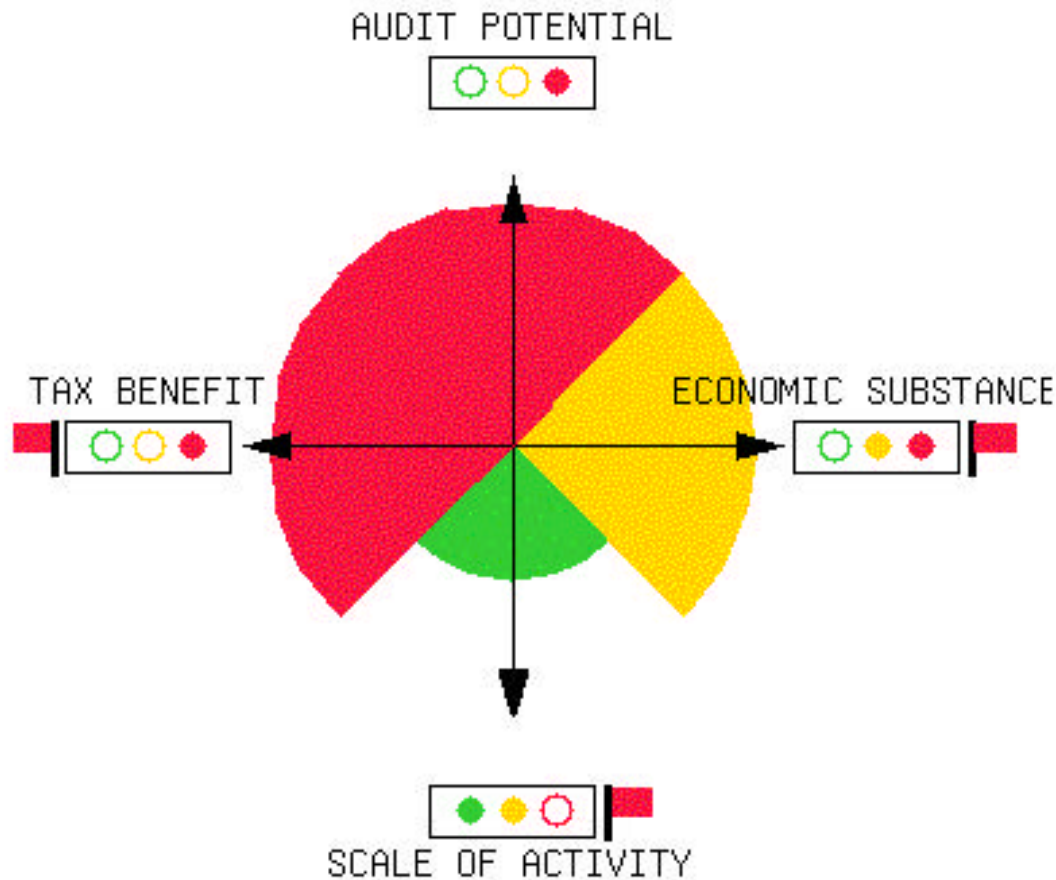
augment with subject matter expertise and field experience

collaboration across multiple IRS operating divisions

Compliance Risk Assessment Using SEAS



SEAS Depiction of Multi-Dimensional Risk Analysis (SC² CRisP)



TAX BENEFIT.Generic-CRISp-test-SC2

8

Work papers can be attached as evidence to support analyst reasoning...

TAX BENEFIT.Generic-CRIsP-test-SC2



Base Question

CURRENT YEAR IMPACT: What is the impact on the

Analyst:

LMSB Research

- ☒ > 10%
- ☐ 5 to 10%
- ☐ 3 to 5%
- ☐ 1 to 2%
- ☐ < 1%

Rationale

Transfer of 90% ownership interest in S-Corp to non-profit entity causes a corresponding reduction in taxable income reported by the other shareholders for each full year that the ownership transfer is in effect. See 4 year comparative analysis for a sample case attached.

Documentary Evidence [1] (use Manual Fusion Method)



See multi-year effective tax rate computation

Analyst: LMSB Research

On: 01 Mar 2004

Relevance: 1999 to 2001 shows reduction in ETR from 39% to 4% for a sample case where shelter appears to operate over three years (partial years in 2000 and 2002, full year for 2001)!!

TIP: To create new **Documentary Evidence**, first create it as an **Exhibit** and then promote it.

Exhibits [1]



See effective tax computation for shareholders.

TIP: To add an **Exhibit**, click on the In-Basket above.

Discovery Tools [0]



http://152.225.145.204:8000/archive/no-date/EX-URL-357881.doc - Microsof...

	Years affected by shelter				Totals
	1999	2000	2001	2002	
Ordinary Income	\$ 4,375,267	\$ 4,981,899	\$ 7,590,568	\$ 7,000,000	\$ 19,582,467
Sheltered ord income	\$ -	\$ 750,837	\$ 6,831,511	\$ 2,625,000	\$ 10,207,348
Ord Inc subject to tax	\$ 4,375,267	\$ 4,241,062	\$ 759,057	\$ 4,375,000	\$ 9,375,119
Individual marginal rate	39.6%	39.6%	39.6%	39.6%	39.6%
Tax	\$ 1,732,606	\$ 1,679,461	\$ 300,587	\$ 1,732,500	\$ 3,712,547
Eff Tax Rate on Ord Inc	39.6%	33.6%	4.0%	24.8%	19.0%

Additional deductions based on tax shelter activity		
Non cash contribution	\$ 835,000	\$ 835,000
Tax shelter fees	\$ 500,000	\$ 500,000
Total	\$ 1,335,000	\$ 1,335,000
Tax Benefit based on ETR	\$ 449,144	\$ 449,144

Tax Savings:		
Difference between marginal rate and ETR x cumulative ord income		\$ 4,042,110
Tax benefit of additional deductions		\$ 449,144
Total Tax savings attributable to shelter		\$ 4,491,253

Spreadsheet showing effective tax rate calculations

also scanned documents ...

BUSINESS PURPOSE.Generic-C



Memo-type: **ASSISTANT SECRETARY CONTACT CRUISE FOR JR**

Memos
01 Mar 2004
1120S evidence LMSB Research

TIP: To manage memos, click the memo button in the toolbar.

Base Question
UNUSUAL TRANSACTION Is the evidence of a large, u

Analyst: LMSB Research : 01
☒ Yes, almost certainly
☐ Likely
☐ Even, about as likely as not
☐ Unlikely
☐ No, almost certainly not

Rationale:
Large charitable contribution from S-Corp to investor
non-profit public employee pension plan.

Documentary Evidence [2] (use **Memo**) Fusion Method)

1120S
Analyst: LMSB Research
On: 02 Mar 2004
Relevance: Income reported
K1 Page 1, 2000
Analyst: LMSB Research
On: 02 Mar 2004
Relevance: Tax year 2000 still shows significant income occurred part way through year.

TIP: To create new Documentary Evidence, first create it as an Exhibit and then pr

Exhibits [0]

TIP: To add an Exhibit, click on the In-Basket above

Discovery Tools [0]

TIP: To add a new Discovery Tool to this Argument, click on the Toolbox above.

Investor
Form 1120-S

Schedule K-1,
showing
highlighted
lines

...and link analysis charts

The screenshot displays a software interface with a sidebar on the left and a main content area. The sidebar includes a navigation menu with icons for a tree view, a list view, and a memo view. The memo view is selected, showing a 'Base Question' section. The question is 'TAX-EXEMPT: Is there a presence of a tax-exempt entity?'. Below the question is a 'Consider the following:' section with a bullet point: 'The following lineitems may be of interest in making this determination'. The 'Analyst' field is 'LMSB Research: 01 Ma'. A legend for the question shows five radio button options: 'Yes, almost certainly' (selected), 'Likely', 'Even, about as likely as not', 'Unlikely', and 'No, almost certainly not'. The 'Rationale' section contains the text: 'Public Pension Plan this same plan is also linked to several other similar S-Corps through other k-1 distributions.' The main content area displays a 'link analysis diagram - SC2 - Windows Picture and Fax Viewer'. The diagram is a hierarchical tree structure. The root node is an oval. It has three children: a left oval, a central rectangle, and a right oval. The left oval is connected to the root by a line labeled '+1'. The central rectangle is connected to the root by a line labeled '+2,142,202' and '-23,760'. The right oval is connected to the root by a line labeled '+1'. The central rectangle has two children: a red rectangle and a grey rectangle. The red rectangle is connected to the central rectangle by a line labeled '+209,979' and '-2,376'. The grey rectangle is connected to the central rectangle by a line labeled '+1,889,906' and '-21,384'. The red rectangle is connected to a bottom red rectangle by a line labeled 'Case SSN'. The left oval has a blue oval child labeled '13 Payers'. The right oval has a blue oval child labeled '27 Payers'. The bottom red rectangle is connected to a bottom red rectangle by a line labeled 'Case SSN'. A red dashed line connects the 'Base Question' section to the 'link analysis diagram'.

link analysis diagram - SC2 - Windows Picture and Fax Viewer

Base Question

TAX-EXEMPT: Is there a presence of a tax-exempt entity?

Consider the following:

- The following lineitems may be of interest in making this determination

Analyst: LMSB Research: 01 Ma

Yes, almost certainly
Likely
Even, about as likely as not
Unlikely
No, almost certainly not

Rationale:
Public Pension Plan
this same plan is also linked to several other similar S-Corps through other k-1 distributions.

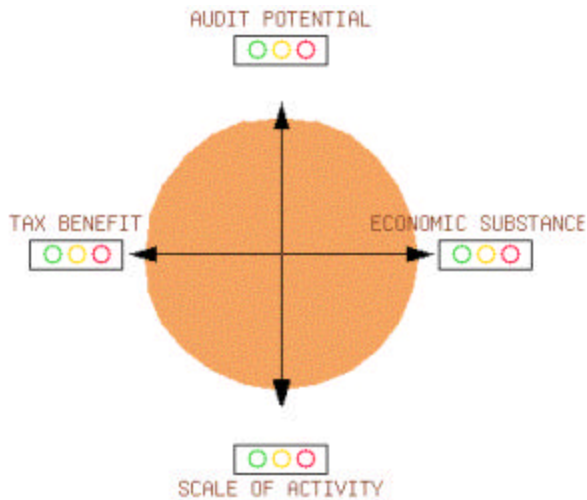
Documentary Evidence [2] (use Manual Fusion Method)

Link Analysis of public Pension Plan

Link Analysis Chart showing related entities

SEAS captures evolving analyst understanding.

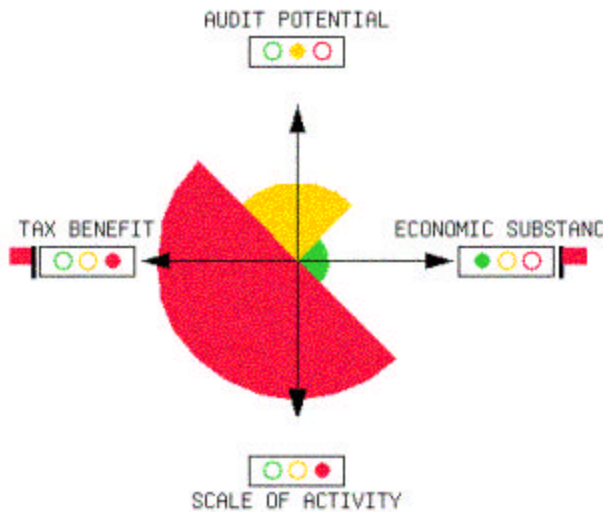
November 2003



SC2 analysis:

- Template created by IRS technical experts, Research Compliance Lab and SRI consultant

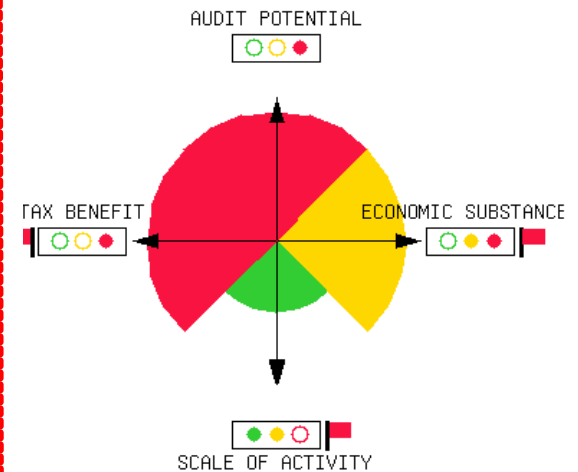
January 2004



- field observations
- research filing patterns
- promoter investigations
- news media

SRPP Research Conference 2004

April 2004



- issue becomes “listed transaction” (OTSA / Counsel)
- unusual transaction involving tax-advantaged entity
- refined search criteria

Benefits to IRS

- ***Managing complexity***
 - Systematic assessment of risk
 - Collaboration
 - Link “data to anecdote”
- ***Improving enforcement cycle time***
 - Access & leverage current knowledge
 - Issue development
 - Return scoring/selection
- ***IRS corporate memory***

Summary

- Need for a new approach at looking at compliance risk.
- Showed the design and implementation of a CRisP in SEAS
- Benefits to IRS

Thank You!

Questions & Live Demo

[Tom Boyce available afterwards to demo SEAS]